

# **Report on the Organic and Natural Industry**

## **Market Opportunities for Producer and Retail Cooperatives**

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# Federal State Market Improvement Program Report Outline

## Table of Contents

### Introduction

### Executive Summary

### Overview of Organic and Natural Foods Industry

Market Growth.....	6
Organics Expected to Overtake Natural Category.....	7
Consumer Trends in Natural and Organic Industry.....	8
Key Dietary Trends.....	9
Incentives for Rise of Organic Category.....	10
Production of Organic Foods.....	11
Growers.....	11
Manufacturers.....	12
Sales Channels for Organic and Natural Foods.....	13
The Organic Value Chain.....	15

### Organic Food Categories

Market Growth.....	16
Produce.....	18
Produce Sales Trends.....	19
Dairy.....	20
Dairy Sales Trends.....	21
Fluid Dairy.....	22
Organic and Specialty Cheeses.....	22
Eggs.....	23
Organic and Natural Dairy Competitive Environment.....	24
Meat.....	25
Meat Sales Trends.....	25
Growth in Supply.....	26
Non-dairy Beverages.....	27
Non-dairy Beverages Sales Trends.....	27
Soymilk.....	28
Juices.....	29
Non-dairy Beverages Competitive Environment.....	30
Grains.....	31
Grains Sales Trends.....	31
Dry Breakfast Foods.....	33
Baking Mixes, Supplies and Flours.....	34
Gluten-Free and Allergen-Free Grains.....	35

<b>Linking Producers and Consumers Through Cooperative Business</b>	
Strategic Cooperative Partnerships.....	36
The U.S. Natural Food Co-op Sector	
Size and Sales.....	37
Competition.....	37
Food Co-op Consumer Research and Branding.....	38
Distribution.....	40
Affinity for Producer Cooperatives.....	41
Existing Producer-Retail Cooperative Partnerships.....	42
Co-op Atlantic and “Market Town” and “Atlantic Tender Beef Classic”	42
Organic Coffee Producer and “Small Farmer” Label.....	43
Food Co-op Buyer Survey: Opportunities for Producers.....	44
Product Categories.....	45
Summary of Market Opportunities.....	46

## **Introduction**

On behalf of Cooperative Development Services (CDS), we thank you for your interest in cooperative food networks and the natural and organic food industry.

We have worked with many organizations and constituencies to help improve American agricultural systems and have seen significant progress. Yet there remain many untapped opportunities, especially in the natural and organic sectors, which could bring farmers and producers closer to reaching critical in-demand markets with their products.

We gratefully acknowledge funding support for this project from a contract with the North Dakota Department of Agriculture, with funding provided by the Federal State Market Improvement Program of the United States Department of Agriculture (USDA)--Agricultural Marketing Service. CDS received their support to conduct market research for producer cooperatives and others serving the natural foods sector. This report presents data that supports how strategic efforts to connect with organic and natural markets through co-op networks can help build a food system beneficial to both producers and consumers.

The research summarized in this report includes:

- Overview of the organic and natural foods industry in five sectors: produce, meat, dairy, grains and non-dairy beverage.
- Summary of interviews with natural food co-op buyers, Co-op Advantage Program and United Natural Foods, Inc. staff, and marketing and membership directors of various cooperatives.
- Identification of distribution, promotion and merchandising opportunities for cooperatively produced organic and natural products.

The statistical data presented on market trends in organic and natural food markets draws heavily upon research by the *Nutrition Business Journal*, *Natural Foods Merchandiser*, Mintel International Group, USDA's Economic Research Services, and various other sources. Unless noted otherwise, data was sourced from the *Nutrition Business Journal* 2004 Organic Foods, and *Natural Foods Merchandiser* Market Overview 2004.

## **Executive Summary**

The research on the organic and natural industry, and the findings of the retail food co-op and producer cooperative sectors about the challenges and opportunities in this market, point to exciting possibilities that can become realities if these cooperatives were to recognize and implement the power of the sixth cooperative principle: cooperation among cooperatives.

We know firsthand the business development challenges that farmers face in trying to compete for shelf space in grocery stores and foodservice businesses. At the same time, we see the growing free-for-all that consumer-owned natural food co-ops are facing from mainstream and big box retailers. Both consumer-owned retailers and producer-owned ventures are facing similar pressures from consolidation and competition.

We believe there are tangible market benefits that could accrue to both farmers and consumers by bringing them together to explore opportunities and address common challenges that could bring them the benefits of greater cooperation. This will allow them to:

- Create a network for meeting mutual needs.
- Succeed in early stages of product development.
- Bring unique products to market.
- Serve as a resource for consumers.
- Strengthen the cooperative advantage.
- Compete and thrive in the mainstream.
- Develop connections to international cooperatives.

## **Overview of Organic and Natural Food Industry**

### **Market Growth**

The market for organic food has been growing at a double-digit rate for almost a decade. In ever-growing numbers, consumers are seeking out organically produced food, and paying a premium for it. This report on the natural and organic industry shows that there are worthwhile opportunities for producers to bring such products to market and meet consumer demand.

The Food Marketing Institute's *Grocery Shopper Trends 2005* noted that the Organic Trade Association reported sales of organic products reached \$12.7 billion in 2004, with a steady growth rate of nearly 20 percent per year over the past decade. According to the Natural Foods Merchandiser's 2004 annual report on both the natural and organic industry, sales have grown vigorously in recent years, reaching an estimated \$45.8 billion in total sales across all retail and direct-to-consumer channels in the United States.

Organic food sales grew between 17 and 21 percent each year from 1997 through 2003, a period during which most conventional food categories grew only 2-5 percent annually. Organic food sales represented 1.9 percent of total U.S. food sales in 2003, up from 0.8 percent in 1997. Roughly 1,100 companies manufactured or marketed organic or natural food on the wholesale level in the U.S. in 2003.<sup>1</sup>

Natural and organic growth is being driven by:

- Consumer demand
- Greater availability of organics due to the growth of natural food chains (Whole Foods and Wild Oats) and migration of organic and natural products into mainstream grocery stores and supercenters
- More competitive pricing relative to conventional product
- Improved taste and quality
- USDA National Organic Standards, which are paving the way for large manufacturers to enter the market
- Significant investment in organic and natural companies
- Growing environmental consciousness among consumers

While growth of organics has been strong, the natural sector has not kept pace. Overall sales growth for natural products ranged from zero to 3 percent annually from 1999 through 2003. In 1997, 61 percent of combined natural and organic food sales were in the natural category. By 2003 naturals had declined to approximately 40 percent of combined sales. The shift from natural to organic is fueled by the growing number of organic producers, manufacturers, and products, following the establishment of the USDA's National Organic Standards, consumer confusion about what "natural" means, and growing consumer awareness of organic foods.

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<sup>1</sup> Nutrition Business Journal Organic Foods Report, 2004

## **Organics Expected to Overtake Natural Category**

In the long run, industry experts believe the combined natural and organic foods category will be 75-90 percent organic. Naturals are likely to fare best in categories like meat, fish, and poultry, and bread and grains, where they will retain 45-50 percent of combined natural and organic sales.

Most industry prognoses point toward continued strong growth for organics through the remainder of this decade. However, the organic market appears to be maturing, with many analysts predicting that growth will trend downward toward 10 percent per year by 2010.

Aggregated results from the joint *National Business Journal* and the Organic Trade Association's 2004 manufacturers survey, project an annual average growth forecast for organic food of 18.4 percent for 2004-2008. As the survey points out, manufacturer forecasts are almost invariably optimistic. However, even the lower growth scenario constructed by the report projects a double-digit annual organic growth of 13.8 percent from 2004 through 2008.

While annual growth rates may decline, they remain substantial and are projected to substantially surpass growth rates observed in the conventional food business as a whole. Furthermore, when these growth rates are applied to larger and larger sales bases, the total volume of organic product sold will continue to increase significantly.

## Consumer Trends in the Natural and Organic Industry

The Hartman Group is a consulting and market research firm specializing in the health and wellness marketplace. According to The Hartman Group's report, *Organic Food & Beverage Trends 2004: Lifestyles, Language and Category Adoption*, at least 66 percent of U.S. consumers now report that they use organic products occasionally. This number of consumers has grown from 55 percent in 2000.

The Hartman Group has determined from their research that consumers who buy wellness products, including natural and organic foods, generally fit into one of three categories, core, midlevel and periphery, based on their commitment to living a healthy lifestyle. The Hartman Group identifies opportunities for growth in the natural and organic market from the largest segment of shoppers, the midlevel consumer (53 percent).

**Core consumers** have engineered their lives so that maintaining well-being is a primary focus of their lifestyle. These are the consumers that “walk the talk” and are interested in products with a high nutritional and quality profile. They value where their food comes from.

**Midlevel consumers** seek to live a healthier lifestyle by watching what they eat and trying natural remedies. This consumer group is more interested in convenience and flavor, and wants to “evolutionize not revolutionize” their diet and lifestyle.

**Periphery consumers** are just learning about wellness products or may be only somewhat interested in healthier living. They may purchase wellness products because they think it's something they should do, but are not committed to it.

Industry experts believe that long term growth of organic food sales ultimately depends on transitioning organic food users up the frequency-of-use chain.



## Key Dietary Trends

Organic and natural foods will also be affected by a variety of broader dietary trends. For instance, some analysts suggest that the number one food trend in coming years will be **growing consumption of high fiber foods**, namely whole grains. Interest in whole grains is fueled by USDA's new dietary guidelines and a post-Atkins shift toward complex carbohydrates. Signaling this shift, General Mills has announced that it will reformulate its entire U.S. cereal line to include significant levels of whole grains. With one-third of the \$7.7 billion U.S. breakfast cereal market, it is also the largest whole-grain foods producer in the U.S.

The **nutraceuticals** field also continues to expand. Although there isn't actually a legal definition of nutraceuticals, also known as functional foods, most of the parties with an interest in this area agree that they are foods marketed as having specific health benefits. For example, drinks are a fast developing area of functional foods; some are fortified with the antioxidant vitamins A, C and E, and others with herbal extracts.

According to a 2002 study by Food Marketing Institute, two-thirds of Americans use nutraceuticals in one form or another. This has made nutraceuticals a \$28 billion category (Mintel, 2004), half again as large as combined organic and natural food sales. Functional foods have been growing 8-10 percent annually since 1998. The largest functional food category is beverages, including waters, energy drinks, soymilk and sports drinks, at \$11.9 billion in 2003 sales. Other leaders for functional foods include breads and grains (\$5.2 billion) and snacks and bars (\$2.3 billion).<sup>2</sup>

Omega-3 fatty acids are an area of particular growth in the functional food arena. A broad array of products are now being enriched with omega-3's including breads, milk, pasta, eggs and packaged bakery items. Growing interest in anti-oxidants is also reflected in expanded sales of blueberries, pomegranate products and other foods that are naturally rich in antioxidants. However, some analysts suggest that the focus on functional foods is waning, with somewhat lower growth rates expected in the future.

Sales of **allergen-free foods** rose 17.2 percent in 2003, topping \$1.8 billion according to *Packaged Facts*. With one in 133 Americans reported to have celiac disease (gluten intolerance) and 1 in 25 sensitive to nuts, manufacturers are swiftly meeting demand for allergen-free foods. Dairy and dairy-alternatives constitute 70 percent of the allergen free category, according to *Natural Grocery Buyer*, with most items available in natural and organic formulations. Gluten-free pasta, flour and baked goods are the second most sought-after products in the allergen-free market. *Packaged Facts* predicts that this market could reach \$3.9 billion within three years.

The FDA now requires manufacturers to include **trans fats** in their nutrition labeling. This is likely to prompt some manufacturers to shift toward healthier oils and some consumers to shift away from products that continue to include trans-fatty acids.

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<sup>2</sup> Nutrition Business Journal Healthy & Functional Foods Report, 2004

## Incentives for Rise of the Organic Category

Underlying the rise of the organic industry is the aging U.S. population, especially the baby boomer generation, which comprises 33 percent of the U.S. population. The *Nutritional Business Journal* views **baby boomer demographics** as the single most powerful driver of organics.

While health related concerns dominate consumer interest in organics, a growing body of research indicates that **“locally grown” and “family farms”** can be as powerful as the organic message alone. A Roper poll conducted on behalf of Organic Valley, a dairy and meat producer co-op headquartered in Wisconsin, determined that 73 percent of consumers surveyed found that information about where their food is grown is “important” to consumers, while 38 percent said it was “very important.”

A survey released at the end of 2003 by the Leopold Center for Sustainable Agriculture at Iowa State University, indicated that 75 percent of consumers surveyed chose products labeled “grown locally by family farms” as their first choice for produce or meat products. About 25 percent of the consumers said they would pay a premium of 6 to 15 percent for products with these additional qualities.

The Roper poll also revealed that Americans believe that smaller scale family farms are more likely to care about food safety than large scale industrial farms, by a 71 to 15 percent margin. About 85 percent said they trust smaller scale farms to produce safe nutritious food, while nearly 70 percent said smaller scale farms are more likely than large scale industrial farms to use techniques that won’t harm the environment.

The advent of the **USDA’s National Organic Standards** in 2002 also bodes well for the long term growth of the organics industry. According to industry executives, uniform national organic standards will foster consumer confidence in organic food, reassure manufacturers that they can differentiate their products, reduce risks for large corporate players and encourage farmers to convert acreage.

Price remained a substantial barrier to the purchase of organics in 2003, with 69 percent of consumers who do not eat organic foods claiming price to be a major factor in their decision, according to a Whole Foods 2003 survey. However, the **price premium for organic foods is continuing to fall**. *Nutritional Business Journal* estimates that the weighted average price premium for organics was about 1.5 times the cost of conventional food in 2002, down from about 2.0 times in 1995. They further suggest that this organic premium leaves room for further development of low-priced, mass-market organic brands. Many observers believe that these premiums must fall further if organic foods are to penetrate the mainstream.

## **Production of Organic Foods**

### **Growers**

According to USDA, 2.35 million acres are now certified organic in the United States as of 2001, up from 918,000 acres in 1995. Overall certified organic cropland and pasture account for 0.3 percent of the US total, as of 2002. The number of certified organic beef, milk cow, hogs, pigs, sheep and lamb increased nearly four times since 1997 to 72,000 head. Milk cows accounted for more than half of the certified animals. Poultry grew six-fold between 1997 and 2001 to over 3 million.

One of the most striking developments in organic agriculture in recent years has been the movement of conventional growers into organics. This has included companies like Dole Fresh Fruit Company, with the production of organic bananas, and companies such as Driscoll, Grimmway Farms, Christopher Ranch, Ocean Mist, and various otherwise conventional growers. NBJ reports that conventional growers now supply the majority of organic produce in the US. With national organic standards now in place, growing participation from conventional farm operations and continued consolidation are expected.

Organic farming is consolidating, acreage is rising and organic production is being concentrated in the hands of fewer growers. More organic crops are being grown, with supply beginning to surpass demand, and competition is intensifying among farmers. There are an estimated 17,000 certified organic farms in the United States, although 11,000 of these make less than \$50,000 per year in annual organic sales. Farms over \$500,000 per year in sales constitute only 3.3 percent of the total number of farms, but account for 54% of sales.<sup>3</sup>

As organic vegetable production consolidates, these farms range from an estimated \$15 million to \$100 million in gross annual sales. According to NBJ, profit margins for organic are increasingly pressured by competition as well as consolidation among distributors and retailers, which has enabled those further up the value chain to leverage more buying power.

Consolidation is particularly tough on mid-size farms too big for direct marketing but too small to work with wholesalers and major retail buyers. Particularly with crops such as apples, entry by large organic producers has contributed to an oversupply that has forced out some small organic growers.

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<sup>3</sup> Nutrition Business Journal Organic Foods Report, 2004

## **Production of Organic Foods**

### **Manufacturers**

Organic foods manufacturing has been marked in recent years by growing involvement by major corporations. There were some 15 key acquisitions and investments in the organic and natural foods sector in 2003, as more independent, organic and natural food companies were sold in whole or in part to conglomerates and private equity firms. There are currently nine companies with organic sales of over \$100 million per year. Collectively they account for 28 percent of total wholesale value of organic foods when unpackaged produce and private label products are included.<sup>4</sup>

Heading NBJ's 2004 ranking of top organic manufacturers was White Wave (Dean Foods), a manufacturer of refrigerated organic soy milk followed by Hain Celestial Group, Horizon Organic Dairy, (acquired by Dean Foods in 2003), and Earth Bound Farm, a grower and packer of organic produce. These are followed in size in organic sales by General Mills (including its Cascadian Farm and Muir Glen brands), Amy's Kitchen, Stonyfield Farm and Organic Valley.

While large corporations continue to expand in organics through acquisition, the list of top 50 organic manufacturers still includes a variety of independent companies including Amy's Kitchen, Organic Valley, Nature's Path, Pacific Foods, Golden Temple, Eden Foods, Spectrum, Apple & Eve, Alvarado Street Bakery, and Annie's Homegrown.

Also striking is the introduction of organic and natural brands by conventional food manufacturers. These include Frito-Lay's Tostitos Organic Yellow Corn Tortilla Chips and Organic Salsa, Cheeto's Natural White Cheddar Puffs, and Lay's Natural Country BBQ potato chips. H.J. Heinz has also introduced organic ketchup. Campbell's Soup added organic tomato juice to its line-up, a product that has experienced rapid growth since its introduction in September 2003.

Reliable supplies of organic raw materials are essential to continued growth of organic food manufacturing. Lack of consistent supply hindered growth of organic manufacturing in earlier years and continues to make some companies reluctant to sell organic brands or to convert natural brands to organic. As organic acreage and yields have strengthened, supplies have become more available but the risk of supply shortages is still a reality.

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<sup>4</sup> Nutrition Business Journal Organic Foods Report, 2004

## Sales Channels for Organic and Natural Foods

Organic products are now available in nearly 20,000 natural food stores and 74 percent of conventional grocery stores<sup>5</sup>. The natural and health food channel remains the largest single channel for organic sales. In 2003, natural food grocery chains, including Whole Foods, Wild Oats and a few other large natural product chains, accounted for 19 percent of organic sales, while independent natural and health food stores, smaller chains and other specialty retailers, accounted for 28 percent. Sales through all natural food stores rose by 71 percent between 2001 and 2004, fueled by the growth of Whole Foods and Wild Oats.

Sales of organic food and beverages through mainstream food, drug and mass merchant channels rose even more rapidly, by 88 percent between 2001 and 2004<sup>6</sup>. Mass-market share of organic sales now totals 44 percent of US organic food sales, up from 30 percent in 1999, with the greatest growth occurring in mainstream grocery chains. Discount stores like Wal-Mart and Costco have moved rapidly into organics as well. Together these two retailers represented about 1 percent of organic sales in 1999, but topped 13 percent in 2001.

Mainstream stores dominate sales of products like nondairy beverages (86 percent of the market), packaged fresh produce (74 percent), baby food (74 percent) and milk (74 percent).<sup>7</sup> The expanded role of major manufacturers with the leverage to place their product in mainstream channels has fueled this growth.

<b>Organic Food Channel Distribution, 2003</b>		
<b>Channel</b>	<b>Sales (\$Mil)</b>	<b>Percent of Organic Food Total</b>
Mass Market Grocery	3,868	37%
Natural Food Grocery Chain	2,011	19%
Natural Food Independent Grocery	2,932	28%
Mass Merchandisers Club	367	4%
Foodservice	264	3%
Export	254	2%
Farmers' Market	165	2%
Other	400	4%
Other	120	1%
<b>Organic Food Total</b>	<b>10,381</b>	<b>100%</b>

<sup>5</sup> USDA, Economic Research Service (*Amber Waves*, February 2003)

<sup>6</sup> Mintel International

<sup>7</sup> Natural Food Merchandiser, Volume XXV

## **Sales Channels for Organic and Natural Foods, continued**

Responding to demand, major retailers are creating new organic and natural formats.

In 2005, Safeway opened 21 new Lifestyle stores and completed 293 Lifestyle remodels; the company anticipates opening 20-25 new Lifestyle stores in 2006 and completing about 280 remodels. The stores feature thousands of organic and natural items, expanded perishables departments, in-store Jamba Juice and Starbucks, open-flame full-service hearth bakery featuring European-style artisan breads, full-service nut bar, and full-service floral kiosks. The introduction of the new stores is credited with driving an overall increase in Safeway sales in 2005, offsetting losses in other divisions.

SuperValu announced the January 2006 opening of their first Sunflower Market in Indianapolis, IN. The format is intended to be a value-priced organic retail format, and will contain grocery, frozen and dairy departments; produce and bulk foods; deli and cheese; all-natural bakery and café; hormone and anti-biotic free meat and seafood; beer and wine; and wellness departments. The 12,000 sq. ft. prototype store is the first of an expected 50 new stores to be opened in the next five years.

Farmers markets accounted for 4 percent of organic food sales in 2003, while food service and exports each accounted for 2 percent of the \$10.4 billion dollar total, according to 2004 manufacturer surveys.

While foodservice is now a small fraction of natural and organic sales rapid growth is expected. Spending for food and beverage away from home has grown to about \$420 billion, nearly half of the total per capita spending on food in the U.S., according to SPINS. SPINS expects that natural and organic sales into foodservice will grow from \$330 million in 2002 to almost \$2 billion by 2007.

Another key trend is the proliferation of organic private labels. Responding to consumers' desire for healthier food at affordable prices, privately labeled organic and natural products are growing in retail settings across the country. For instance, Safeway has added a "Select Organics" line extension to its house brand, while Kroger's "Naturally Preferred" brand now includes organic dairy. Target, Giant Food, Wegmans Food Markets and the Canadian chain Loblaws are all expanding sales of organic and/or natural privately labeled products.

Whole Foods led this trend with its pioneering "365 Everyday Value" line (now the largest private organics line in the country), the "Whole Kids Organic" line and its more recent co-branded artisan line that bears the manufacturer's own brand plus "Authentic Food Artisan, Presented by Whole Foods." Trader Joe's derives a whopping 80 percent of its sales from private label products and now offers a range of privately labeled organic and natural items. The Private Label Manufacturers' Association estimates that one of every five items sold at retail in supermarkets, drug stores and mass merchandisers carries a house brand, for a total exceeding \$50 billion. They estimate that shoppers save \$15.8 million per year by buying private label products.

## The Organic Value Chain

NBJ estimates that consumer sales of organic foods were \$10.4 billion dollars in 2003. This reflects wholesale values of \$6.7 billion and farm gate sales of \$2.3 billion as shown in the chart below.

### Organic Industry Value Chain Analysis, 2002-2003

<b>U.S. Organic Value Chain Analysis</b>	<b>2002 (\$mil)</b>	<b>2003 (\$mil)</b>	<b>Growth 02-03</b>
Consumer Sales (\$mil)	8,630	10,380	20%
Wholesale Total (Farm Produce & Packaged)	3,877	4,826	24%
Retail Distributors Revenues	517	630	22%
Processor/Farm Distributor/Broker Revenues	58	73	27%
Farmgate Produce Sales	1,473	1,777	21%
Farmgate Supply Sales for Mfgd Organic Foods	455	580	28%
<b>Total Farmgate Sales</b>	<b>1,928</b>	<b>2,357</b>	<b>22%</b>

Source: Nutrition Business Journal

After four years of analysis of the organic value chain, NBJ finds no considerable accumulation of value or margins at any particular level of the chain. Consumer sales, wholesale sales, distributor sales all rose between 45 and 48 percent in the two year period of 2000–2002 and between 21 and 28 percent in 2002–2003. It is widely believed that mark-ups along the value chain and distributor and broker fees are higher for organic products than most other products having higher value or broader distribution. This contributes to higher premiums for organic than farm costs would indicate.

Prices and premiums appear to be eroding slightly and some of the larger categories such as milk, soymilk and produce segments are becoming somewhat commodified. NBJ also reached the following conclusions in its 2004 Organic Foods report:

- Farmers have volatile and unpredictable profits and are dependent on demand from the evolving manufacturing segment of the organic food sector.
- Farmers are as vulnerable to commodity pricing as they are in conventional farming, but it's exacerbated by the smaller scale of the organic supply business.
- Small organic farms are more vulnerable and have a higher rate of attrition.
- On processor and manufacturing levels, firms have somewhat more control over margins. Distributors and retailers also view organic as higher margin potential and mark-up products to reflect this.
- The greatest potential for consistent profit growth is in manufacturing with selective integration into supply and alternative distribution.

## **Organic Food Categories**

### **Market Growth**

While produce and baby foods may be the first categories to draw shoppers new to organics, consumers are now buying organic products from every department in the store. United Natural Foods, Inc., for instance, identified the top five categories for 2003 as baking mixes, bulk nuts and seeds, frozen baked goods, nutrition bars, and perishables in general.<sup>8</sup>

Not surprisingly, the fastest growth rates are occurring among smaller categories, particularly meat, fish, and poultry, and snack foods, as reflected below. Other organic products with rapid growth include cold cereals (46 percent), eggs (29 percent), organic bread and baked goods (27 percent), packaged fresh produce (26 percent) and yogurt and kefir (23 percent).<sup>9</sup>

### **Organic Food Growth Forecast**

<b>Major Categories</b>	<b>2004-08 CAGR</b>
<b>Total Organic Food</b>	<b>13.8%</b>
Dairy	15.6%
Breads & Grains	14.7%
Beverages	15.0%
Snack Foods	18.1%
Packaged/Prepared Foods	13.6%
Condiments	14.8%
Fruit & Vegetables	11.1%
Meat, fish, poultry	43.4%

Source: Nutrition Business Journal

Forecasts predict organic foods will increase penetration of the conventional food market from 1.9 percent in 2003 to 3.5 percent by 2010. By contrast, natural sales are projected to remain essentially flat.

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<sup>8</sup> Natural Food Merchandiser, Volume XXV

<sup>9</sup> SPINS/Natural Food Merchandiser June 2004



### Organic Food Categories, Market Growth, continued

As shown below, produce, non-dairy beverages, packaged foods, and dairy are the largest categories in the organic area, collectively accounting for almost 75 percent of total organic sales. Each has penetration rates above the average figure of 1.9 percent of US food sales overall.

#### Growth of Major Organic Food Categories

Major Categories	% of Organic Sales	03 Growth
<b>Total Organic Food</b>		<b>20.4%</b>
Fruit & Vegetables	42%	19.9%
Beverages	15%	19.3%
Dairy	13%	20.3%
Packaged/Prepared Foods	13%	16.0%
Breads & Grains	9%	22.9%
Snack Foods	5%	29.6%
Condiments	2%	23.5%
Meat, fish, poultry	1%	77.8%

Source: Nutrition Business Journal

## Produce

Fresh organic produce represents the largest segment of the organic foods business with \$4.0 billion in 2003. Produce in general is a growing section in supermarkets, with consumption of all fresh fruits and vegetables increasing by more than 12 percent from 1987 to 1997. Driven in part by health and nutritional concerns, the average supermarket produce section carries 335 items, almost twice the number of ten years ago.

Historically the largest organic sector, produce sales exceeded \$4.3 billion in 2003, representing almost 40 percent of all organic food sales. This reflects a tripling of sales since 1997. Fresh produce constitutes about 92 percent of the category, with frozen fruit and vegetables and canned each representing about 3 percent of the remainder. NBJ projects compound annual growth for U.S. organic production of 13.4 percent from 2004 through 2008, with sales of \$8.5 billion in 2010.<sup>10</sup> Approximately 46 percent of organic fruits and vegetables are sold through natural food channels. Mass-market channels sell 39 percent, with the remainder moving through various direct market and other channels.

Less than 0.5 percent of U.S. cropland and pasture was farmed organically in 2003, according to USDA. In California, the nation's leader for organic produce production, registered organic farmers reported sales of \$260 million from organically grown commodities in 2002, up from \$75 million in 1992 according to Karen Klonsky at the University California, Davis.

The number of registered organic farms in California has also swelled by more than 50 percent during the same 11 years to nearly 2,000 growers. Acreage quadrupled to almost 170,000 acres. Organic grapes, lettuce, carrots, strawberries and tomatoes have enjoyed the most rapid growth. However, more acreage was planted to rice than any other single crop. The price spread between organic and conventional produce continues to narrow as organic supply expands.

Organic produce remains much less consolidated than conventional production. A diverse producer base including many small growers supplies a wholesale distribution network that thrives on long term personal relationships, organic expertise and regional and niche marketing.

However, several notable consolidations have occurred in recent years. This includes Cal Organic Farms and Grimmway Farms, which became one corporation in 2001 when Grimmway acquired Cal Organic. In addition to its own production operations, Grimmway purchases products from a wide variety of smaller independent growers, providing them boxes, trucking, refrigeration, and handling support. Provision of post-harvest handling has made a significant difference in enabling smaller producers to improve the appearance and quality of their product and to reach larger markets.

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<sup>10</sup> *Nutrition Business Journal Organic Foods Report, 2004*

## Produce Sales Trends

Fresh carrots, apples and lettuce are among the top organic sellers, especially in supermarkets, due to their perceived longer shelf life. However, some supermarkets remain reluctant to expand further into fresh organic produce due to the more challenging handling requirements of organic produce such as cucumbers that aren't waxed and organic heirloom tomatoes that have a shorter shelf life because they are not gassed.

**Branding of fresh produce** is on the rise. Nationally branded conventional produce reached 19 percent of produce department sales in 1997, up from 7 percent ten years earlier.<sup>11</sup> The branding trend is even more pronounced in the organic arena. According to NBJ interviews with distributors, branded fresh produce constitutes 30 to 40 percent of total organic produce sales through retail channels. Sales of **packaged organic convenience items** like bagged salads are among the fastest growing, with organic bagged salads now representing 6 percent of that sub-category.

The ability to clearly label organic product as such on packaging is aiding growth of branded products. Use of UPC codes on packaged product is also attractive at retailers, particularly supermarkets that have suffered shrinkage due to confusion between loose organic fruit and vegetables and conventional at the register.

**Market development for different grades of organic produce** is also growing, helping to fill gaps in the infrastructure of the organic agricultural economy. For instance, Lady Moon, one of the largest certified organic vegetable growers on the East Coast, has established a secondary brand name, East Coast Organics, for its grade two produce, retaining grade one for its Lady Moon label. Pricing tiers are especially apparent in fruit.<sup>12</sup> NBJ reports that demand for frozen fruit to go in smoothies and similar products are growing. Lesser grades of frozen fruit are also used for jams, jellies and purees for use in yogurts and beverages.

US sales of **organic frozen fruits and vegetables** reached nearly \$150 million in 2003. The market is dominated by Cascadian Farms with slightly more than 50 percent of sales in this category. Family-owned Sno Pac is a long-running brand with 2003 frozen sales of \$3.1 million. Retailers Trader Joe's and Whole Foods Market, as well as distributor Tree of Life have also instituted their own in-house brands of frozen fruits and vegetables. NBJ predicts that this category will have compound annual growth rate of approximately 15.6 percent from 2004 through 2008.

The smallest component of the organic produce market, **canned fruits and vegetables** are nonetheless enjoying rapid growth. From a modest base of \$36 million sales in 1997, canned organics reached \$110 million in 2003. NBJ projects annual growth rates of 29.5 percent annually from 2004 through 2008, well in excess of organic growth rates overall.

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<sup>11</sup> Economic Research Service, USDA.

<sup>12</sup> Nutrition Business Journal Organic Foods Report, 2004

## Dairy

Overall, the total conventional dairy category sales have leveled off or dropped in recent decades. Contributing to this decline is competition from beverages like carbonated soft drinks and bottled water, a smaller percentage of children and adolescents in the U.S., and a more ethnically diverse population whose diet does not normally include milk. Milk drinkers are also shifting away from whole milk, which constituted 68 percent of total fluid milk sales thirty years ago, to lower fat and skim milk, now representing about two-thirds of the market (USDA).

US fluid milk sales have been nearly flat since 1975, with current sales of about \$11 billion per year<sup>13</sup>. Per capita consumption of fluid milk has dropped from 261 pounds in 1975 to 206 pounds in 2003. Per capita use of butter has been fairly steady since the early 1970s, settling at 4.5 pounds in 2003 (USDA). Use of most dry and condensed milks has declined as in-home food preparation has diminished, and use has shifted to commercial food preparation.

Consumption of ice cream has fallen slightly over the last three decades to 24.1 pounds per capita per year (USDA). However, while overall consumption has declined, interest in higher priced, higher milk fat premium and super-premium ice creams, frozen yogurt and other frozen dairy products has increased.

Cheese continues to be a bright spot in the dairy arena. U.S. consumption of cheese has nearly tripled since 1970 to 30.6 pounds per capita<sup>14</sup> and 8.6 billion pounds in total in 2003.<sup>15</sup> This growth has been stimulated by interest in ethnic foods that use cheese, the convenience of cheese snacks, desire for variety, and increased attention to calcium consumption and high-protein diets, among other trends.

Cheddar and mozzarella together represent about two-thirds of US cheese production. Roughly 60% of cheese now comes in commercially manufactured and prepared foods (including for foodservice) such as fast food sandwiches and packaged snack foods.<sup>16</sup> Among the fastest growing cheese products are convenience items like shredded cheese in re-sealable bags, single serving baby Gouda, and individually wrapped cheese sticks. Per capita consumption is expected to rise to 37.5 pounds by 2009.<sup>17</sup>

Prices received by farmers for conventional milk plummeted to a 12-year low in early 2000 but rebounded to new highs in 2004 and 2005. Payments to farmers for organic milk were in the range of \$18-21 per hundredweight compared to conventional milk at \$9-12.

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<sup>13</sup> National Business Journal, Organic Foods Report 2004

<sup>14</sup> USDA, Economic Research Service: Structural Change in the Meat, Poultry, Dairy and Grain Processing Industries, March 2005

<sup>15</sup> USDA

<sup>16</sup> USDA, Economic Research Service, Amber Waves, June 2003

<sup>17</sup> Food Processing Center, University of Nebraska, Lincoln: The Specialty Cheese Market, October 2001

## Dairy Sales Trends

While the overall market for US dairy has been relatively flat, the organic dairy market continues to flourish. An early leader in the organic food industry, total organic dairy sales reached nearly \$1.4 billion in 2003 with a penetration rate averaging 2.8 percent.<sup>18</sup> Fueled by rising interest in organics and consumers' concern about bovine growth hormones in cow's milk, organic dairy sales have more than tripled since 1997.

As shown below, organic milk and cream sales represent nearly half of this amount, with yogurt accounting for about 30 percent. Organics represent about 2.3 percent of overall dairy sales nationwide and 1.8 percent of the fluid milk market.<sup>19</sup> NBJ also reports that organic milk penetration has reached 5 percent in Denver and 8 percent in San Francisco.

**US Organic Dairy Category Sales, 2002-2003 (\$ million)**

	<b>2003 Sales</b>	<b>Growth rate 2002 – 2003</b>	<b>Projected Growth Rate 2004-2008</b>
Milk/cream	\$666	19.2%	15.8%
Yogurt	\$406	22.3%	15.6%
Eggs	\$117	24.4%	16.3%
Cheese	\$95	20.7%	14.9%
Butter/Cottage Cheese/ Sour Cream	\$87	12.4%	12.4%
Ice Cream	\$14	33.2%	22.0%
<b>Total</b>	<b>\$1,385</b>	<b>20.3%</b>	<b>15.6%</b>

*Source: Nutrition Business Journal*

Many manufacturers are also responding to growing consumer interest in heart-healthy omega-3 fatty acids by **fortifying milk and shifting feeding practices for layer hens** to produce eggs higher in omega-3. NBJ also estimates sales in the natural dairy segment of \$214 million in 2003, or roughly 13 percent of the combined natural and organic category. This includes a range of products including “grass-fed” or pasture-raised fluid milk, cheese, and butter, as well as free-range, vegetarian-fed and other types of eggs. **While a market for pastured, no-hormone, no-antibiotics and similar production practices clearly exist, the move toward organic is fueled by growing consumer confidence in organics** and the growth of major players in the organics arena.

Growing **demand for allergen-free foods** is also being felt in the dairy case, with 70 percent of that market in dairy and dairy-alternative products including soymilk, lactose-free dairy, and sheep and goat milk products.<sup>20</sup>

<sup>18</sup> Nutrition Business Journal, Organic Food Report 2004

<sup>19</sup> National Business Journal, Organic Foods Report 2004

<sup>20</sup> Natural Grocery Buyer, Winter 2005

## **Fluid Dairy**

In 2004/2005 demand for organic milk sharply outstripped available supply, leading to significant price hikes. According to Katherine DiMatteo of the Organic Trade Association, demand was about 10 percent greater than supply in early 2005<sup>21</sup>. Given the relatively small size of the organic dairy market, continued cycles of under-supply and over-supply can be expected as the industry matures. The price premium for organic production is likely to encourage continued growth of the US organic milk cow herd.

The Organic Trade Association expects organic milk sales to grow by an average of 17.3 percent per year between 2004 and 2008,<sup>22</sup> with NBJ projecting 15.8 percent annual growth of organic milk and cream over the same period. Growth on that scale amounts to fluid organic dairy sales of roughly \$1.4 billion by 2008, and total organic dairy sales (fluid and processed) of almost \$2.9 billion. This is equivalent to a new player of Organic Valley's size entering the market every year over that period.

According to NBJ, Horizon Organic believes organic milk has the potential to reach 10 – 20 percent of the overall market over the long-term, with CROPP suggesting that demand will reach 5 percent of total fluid milk sales within the next four years. Consumer demand is likely to be tempered by the significant price premium commanded by organic milk, with retail prices now averaging about \$3.00 per half gallon.

Private label milk brands are increasingly common among larger retail chains, with many groceries carrying more than one brand of organic milk. Much of this milk is sourced from Organic Valley and Horizon. Retailers like Trader Joe's are already undercutting the price of branded organics with privately labeled products.

## **Organic and Specialty Cheeses**

As noted above, the domestic cheese market overall has enjoyed considerable growth in recent years. Sales of organic cheese and cheese alternatives have been even more rapid. NBJ estimates that the organic cheese market has grown by an average of 18.9 percent per year since 1997, topping \$95 million in 2003. The organic cheese market continues to be dominated by Horizon and Organic Valley. They accounted for 33 percent and 27 percent of total 2003 sales, respectively. The next five largest producers generated another 23 percent of total sales, with a large number of small producers under \$500,000 in annual sales accounting for the balance. Unlike fluid milk, which is sold largely through mainstream supermarkets, most organic cheese is sold through natural food retail channels.

Specialty cheeses are typically those having unique qualities such as exotic origin, particular processing approaches, unusual design or packaging and/or limited supply. A

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<sup>21</sup> Washington Post, June 2, 2005

<sup>22</sup> Washington Post, June 2, 2005

common denominator for specialty cheeses is very high quality.<sup>23</sup> According to a U.S. Gourmet Specialty Foods Market report published by Packaged Facts, retail sales of specialty cheese reached nearly \$2.4 billion in 2000 with annual growth of about 4 percent annual over the prior five years. Among the cheeses showing strongest growth are Asiago, Gorgonzola, Brie, and Havarti.

Wisconsin is the only state to track specialty cheese production separately from commodity cheese production. Specialty cheese accounted for 10.1 percent of Wisconsin's cheese output in 2000, up from 4.1 percent in 1993.<sup>24</sup>

According to the Packaged Facts report, specialty cheese sales are expected to reach \$2.9 billion in 2005. They estimate that supermarkets will generate 55 percent of specialty cheese retail sales, specialty cheese stores 30 percent, natural food and health stores 5 percent, with other formats generating the balance.

Driving the growth of specialty cheeses are increased international travel and familiarity with unique cheeses from Europe and elsewhere, restaurants adding cheese courses to their menus, consumers' desire for great variety and more robust flavors, growing ethnic populations and interest in ethnic foods, and greater availability of unique cheeses.<sup>25</sup> Of late, exotic domestic cheeses have benefited from the rising cost of imported cheeses that has resulted from the weak US dollar.

## Eggs

Sale of organic eggs, a favorite among low-carb natural consumers, grew 28% in 2003 to approximately \$117 million according to NBJ. SPINS rated organic eggs among the faster growing product areas for the year. The penetration rate for organic eggs appears to be over 4.5% of the \$2.5 billion US egg market.

Horizon Organic, Organic Valley, Chino Valley Ranchers and Country Hen lead the pack of organic providers, together representing about 50 percent of the market. Growing interest in DHA and EPA and omega-3 fatty acids, is also being felt in the egg case. For instance, in natural supermarkets, sales of DHA Omega-3 eggs now have a 23 percent share of total eggs sales. DHA egg sales are growing at a rate of 42.7 percent, nearly twice the rates of non-DHA eggs.<sup>26</sup>

Eggs are the second largest private label item in the dairy case after milk. Specialty eggs (including organic and functional among others) are primarily sold as branded product, although Trader Joe's has an in-house organic egg line.

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<sup>23</sup> Cheese Reporter, July 27, 2001

<sup>24</sup> Cheese Reporter, July 27, 2001

<sup>25</sup> Food Processing Center, University of Nebraska, Lincoln: The Specialty Cheese Market, October 2001

<sup>26</sup> Natural Grocery Buyer, Winter 2005

## **Organic and Natural Dairy Competitive Environment**

The competitive landscape for organic dairy continues to evolve. In 2003, Horizon Organic was acquired by \$9 billion conventional dairy giant Dean Foods Co. Along with Silk brand soymilk, which it acquired in 2002, Dean now owns the two largest organic brands in the U.S. Organic Valley, the second largest organic dairy, has elected to remain an independent cooperative. Horizon and Organic Valley continue to dominate the U.S. organic milk market, representing a combined 75-80 percent of branded organic milk sales (NBJ).

A newer entrant in the organic milk market is Aurora Organic Dairy. Aurora is focused on private label sales of organic milk in supermarkets and institutional foodservice markets. Only about 10 percent of organic milk sales in supermarkets are from privately labeled product, compared with 70 percent for conventional milk. Organic consumers appear to prefer branded lines with an emphasis on products they feel are trustworthy.

NBJ reports that Aurora expects to tap into those consumers who are not currently buying organic food with organic milk offerings priced somewhat below branded organic milks. If Aurora's near-term plans are realized, the company could soon become the second largest organic dairy producer in the U.S. It would also be the most vertically integrated, with its own certified bottling plant. This is unique because there are few major organic dairy producers with their own processing plants.

At the retail level, natural grocery stores accounted for 45 percent of organic dairy sales (about \$640 million). Of this, Whole Foods and Wild Oats together represented 31 percent, with independent and smaller scale natural food groceries accounting for 14 percent. However, the mass-market grocery channel accounted for another 43 percent of sales, a figure that appears likely to continue its upward climb.



## Meat

### Meat Sales Trends

According to the 2004 Nutrition Business Journal, the "...fastest growing category in organic food in 2003, up 78 percent, was meat, albeit from a fairly small dollar base." This growth is expected to continue with a projected growth of 31 percent per year through 2008, and there is a large potential for growth in the convenience and prepared food and deli sectors.

In contrast, red meat consumption in the conventional market between 1993 and 2003 (beef, veal, pork, lamb and mutton) has remained relatively stable. Fish and shellfish sales have seen an increase over the past three years due to increased fresh and frozen fish and shellfish consumption, while canned and cured fish saw very little variance. Poultry has increased by about 10 pounds per capita from 2002 to 2003, due to the increase in the consumption of chicken.

### Organic Meat Sales

	<b>2003 Sales</b>	<b>Projected AGR 2004-2008</b>
Beef	\$10 million	39.2%
Poultry	\$46 million	48.6%
Pork	\$3 million	32.3%
Sausage/Deli	\$16 million	21.0%
<b>Total Organic Meat Sales</b>	<b>\$75 million</b>	<b>43.4%</b>

Source: Nutrition Business Journal

As consumers continue to buy prepared and ready to serve foods, organic meat options should increase as well. Amy's Kitchen, founded in 1987, currently has annual sales in excess of \$100 million for its prepared meals, soups, sauces and chilies. Organic and natural offerings are also starting to show up in casual restaurants and even fast food establishments. Burgerville USA is a regional fast food chain in the Pacific Northwest that uses Oregon Country Beef. Panera Bread Co. has begun using natural chicken, and Chipotle Restaurants have used meat supplied by Niman Ranch for the past couple years.

Growth will be attributed to consumers' increased exposure to natural and organic meats, continued concern over how the animals were raised, and greater use of natural and organic meats in prepared foods. In addition, consumers are increasingly interested in breed specific items that can be raised as natural or organic, such as Angus beef or Berkshire pork.

Natural and organic meats have typically been found in high end retail, specialty, or cooperative food stores that look to serve alternative products. They are also gaining a stronger presence in conventional retail. In 2003, nearly half of all organic meat, fish and poultry sales were distributed through mass market retailers. The NBJ points out that "...a quality meat department is a key attraction that influences where consumers decide to shop." As consumers are looking for alternatives to conventionally raised meats, retailers are going to offer products to better serve their customers.

## **Meat Sales Trends, continued**

Common consumer trends in meat sales include the perception of organic food as a premium or “gourmet” product, concern about environmental issues, animal husbandry, the price and greater availability to organic foods.

Gaining much more prominence in a consumer’s purchasing decision is whether the food is “locally grown” or from a “family farm.” An Iowa State University study found that “locally grown” and “family farm” labels could be just as powerful as organic. Consumers said that if price and appearance were equal, they would choose products with those features over organic options.

The largest consumer driver for purchasing natural and organic meat is that these meats are perceived as safer and “cleaner” than conventionally raised meats that can use antibiotics, steroids or growth hormones. Other common drivers include environmental concerns and animal safety. Sourcing and trace-ability were also mentioned, as well consumers who feel that natural and organically raised meat tastes better.

## **Growth in Supply**

Currently supply cannot keep up with demand. This is due to many reasons including the rapid growth in demand for organics, the time and cost to obtain organic certification, and a lack of organic grain supply and feed mills (and in the case of beef, a relatively long production cycle from conception to slaughter compared to other livestock species).

Given the increasing consumer demand for organic, and to a lesser extent naturals, supply should continue to increase. The higher price premiums for these products, as well as the growing interest in the values associated with organics, is a motivating force in closing the gap between supply and demand. The growth of organics as a whole industry points to strong potential for organic meat production.

There is significant potential and opportunity for natural and organic meat sales in processed and frozen prepared foods. These include products like frozen meals and entrees, canned soups, and baby foods. As this segment expands, the need for additional product will be required. In addition, prepared foods could provide a viable and necessary destination for less desired cuts of meat that move with lower frequency in the retail and foodservice channels.

The market for organic sausages and deli meats is relatively small, only \$16 million in sales in 2003. However, large companies such as Applegate Farms and Penn Valley Farms (BC Natural Foods) specialize in processed meat products, as do other companies such as Organic Valley and Niman Ranch. In addition, as the market for organic meat products grow, markets will need to be developed for processed products as companies will look to utilize their trim and end meats. It is also safe to assume that as demand grows for organic meats, demand should also grow for organic processed products.

## Non-dairy Beverages

### Non-dairy Beverage Sales Trends

The organic beverages category has been a dynamic segment, with new product formats, mergers and acquisitions, surging growth by recent start-ups, and continuing penetration of private-label products.

Sale of organic beverages topped \$1.58 billion in the US in 2003, up from \$471 million in 1997. The category as a whole has grown at annual rates between 19 and 22 percent since the late 1990s. By contrast, sales of soda pop, coffee drinks and conventional fruit-flavored drinks have been nearly stagnant over the past five years.

The category includes fresh and frozen juices, soymilk, tea, coffee, and canned and bottled juices of various sorts. The largest by far is soymilk, with 2003 sales of \$927 million, nearly 60 percent of the category. Canned and bottled juice and drinks follow this, with \$181 million in sales (11 percent of the organic category), and organic tea with \$125 million (8 percent). With annual U.S. sales of \$98 million, fresh organic juice represents 6 percent of sales in the organic beverage category.

*US Organic Beverage Sales (\$ millions)*

	<i>1997</i>	<i>2003</i>	<i>2010 Projection</i>
Soymilk	268	<b>927</b>	1,794
Canned and bottled juice and drinks	47	<b>181</b>	679
Tea	34	<b>125</b>	562
Fresh juice	45	<b>98</b>	236
Frozen juice	8	<b>17</b>	30
Non-soy dairy alternatives	18	<b>46</b>	86
Total category	471	<b>1,581</b>	3,878

*Source: Nutrition Business Journal Organic Foods Report, 2004*

Market penetration of organic beverages has risen from 0.65 percent of the U.S. beverage market in 1997 to 1.59 percent in 2003. About 50 percent of organic beverage sales occur through natural food distribution channels, with another 42 percent sold through mass-market channels.

Spurring this growth is growing interest in dairy alternatives by lactose intolerant consumers, who are estimated to make up 15 percent of the U.S. population. Also having an impact is a greater interest in soy's health benefits, expansion of nutraceuticals of various forms, and growing demand for innovative grab-and-go beverages.

## Soymilk

Soymilk was popularized by Eden Foods, which introduced the Edensoy brand in 1983. Previously regarded as an Asian product, it quickly became one of the highest velocity items in the nutrition industry and founded the non-dairy liquid category more or less single handedly. Soymilk sales were up nearly 26 percent in 2004, totaling roughly \$380 million<sup>27</sup>.

Spurring this growth has been growing interest in soy's health benefits, growing numbers of lactose intolerant consumers and widening interest in non-GMO soy products. Soy products can now carry a heart-healthy claim, which helps to further position soymilk as the darling of the dairy case.

There are now about 20 soymilk brands, but the top five (Silk, Eden Foods, Pacific Foods, Vitasoy and Westsoy) dominate 90-95 percent of the market, according to Soyfoods Center. (Organic Valley entered the category with three flavors in late 2004, and moved rapidly into the second place in marketshare, though still a distant second to Silk). Silk alone represents about 60 percent of the market for soymilks. Private labeled soymilks have also begun to appear in stores, such as Trader Joe's. Given substantial investments in marketing by leading manufacturers, soymilk has become a branded product, where other soy products like tofu and tempeh, have not.

Soy beverage manufacturers have also focused on the "functional" category, offering products fortified with vitamins, calcium and isoflavones.

However, genetically modified organisms (GMO) contamination continues to be a concern for manufacturers of organic soy.

Demand for allergen-free foods is also on the rise. In 2003, sale of allergen-free foods rose 17.2 percent to more than \$1.8 billion. Seventy percent of that market is for dairy and dairy-alternative products.<sup>28</sup>

The range of soy-based products continues to grow. White Wave has launched Silk Live, a smoothie made of cultured soy and fruit aimed at the grab-and-go consumer. They also offer Silk Light, which has 50 percent less fat and fewer calories than skim milk. Non-dairy frozen desserts have also expanded smartly and are proving an effective way to reach out to lactose intolerant consumers.

NJB projects that U.S. sales of organic soymilk will grow at a compound rate of 13.9 percent annually from 2004 to 2008.

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<sup>27</sup> Natural Grocery Buyer, Winter 2005

<sup>28</sup> Natural Grocery Buyer, Winter 2005

## Juices

Organic juices and ready-to-drink juice beverages combined were a \$300 million category in 2003. While sales have tripled over the past seven years, the category faces competition not only from conventional and natural beverages but also from products marketed for functionality, novelty, convenience and low-carb attributes. For instance, Odwalla (now owned by Coca Cola) introduced three organic juices in 2002, but indicates that primarily its fortified beverages are driving the brand's growth. Hansen Natural Corp., which acquired Blue Sky Natural Soda in 2000, has a narrow line of organic items but has rolled out myriad natural and functional beverages.

At \$2 to \$3.50 per pint, "superpremium" fresh juices and juice blends are among the highest-value products in the natural, organic and functional beverage segment. However, manufacturers have had to work hard to squeeze adequate profit out of their lines.

Horizon and Odwalla are the leading providers of organic refrigerated juices and functional beverages, together representing about 36 percent of this \$98 million area. Organic Valley has about 8 percent of the market. Cascadian Farms is the market leader for frozen organic juices and beverages. NBJ projects that organic fresh juice sales will have a compound annual growth rate of 18.8 percent from 2004 through 2008, with frozen juices growing by 12.5 percent over that period.

A handful of manufacturers have recently launched fruit drinks fortified with antioxidants, including blueberry and pomegranate formulations. Growing interest by some manufacturers in reducing high fructose corn syrup may spur greater use of organic cane juice and honey.

## **Non-Dairy Beverage Competitive Environment**

The category has been marked by rapid consolidation in recent years. Smucker Quality Beverage (SQB), a division of J.M. Smucker Co. has achieved a dominant position in the natural, organic and functional beverages through acquisitions and brand extensions. Three SQB brands—Knudsen, After The Fall and Santa Cruz Organics—accounted for 51 percent of the shelf-stable juice and functional drinks category in 2003. Walnut Acres accounted for another 24 percent.

Dean Foods and Coca-Cola also acquired organic beverage leaders Horizon Organic and Odwalla, respectively. Particularly in the fresh juice segment, the high cost of operating far-flung refrigerated storage and shipping infrastructures has driven consolidation. Smaller players may need larger partners if they are to move beyond regional distribution.

NBJ suggests that this market is still highly responsive to new and innovative products, citing the rapid growth of Healthy Beverage Co. and Columbia Gorge Organic Fruit as examples. However, Smuckers' long running dominance in the natural food retail juice aisle creates a formidable barrier to entry for start-ups and small companies.

## **Grains**

### **Grains Sales Trends**

A number of dietary trends bode well for the organic and natural grains category. For instance, some analysts suggest that the number one food trend in coming years will be growing consumption of high fiber foods, namely whole grains. Interest in whole grains is expected to be fueled by USDA's new dietary guidelines and a post-Atkins shift toward complex carbohydrates.

Also, the FDA recently approved a qualified health claim for the two types of omega-3 fatty acids commonly found in flaxseeds, hemp and fish oil. Omega-3 fortified foods, including cereal, bread, crackers, can now carry labels stating that "consumption of EPA and DHA omega-3 fatty acids may reduce the risk of coronary heart disease." This has led to the rapid adoption of the label on omega-3-fortified products, particularly with dry cereals. Given the absence of larger brands, there appears to be room for new entrants. Heightened interest in flax is fueling rapid growth of flax-fortified cereals (such as those offered by Nature's Path and Health Valley), crackers and granola.

Organic and natural rice, soy beans, wheat, corn and other grains are sold in bulk at retail and health food stores, packaged under various brand names for sale in retail outlets. They also are sold as ingredients to cereal manufacturers, soymilk producers, and frozen and canned food manufacturers.

Scanned sales of organic beans and rice reached \$32.6 million in 2003 according to NBJ, up sharply from less than \$23 million in 2001. Leading the pack is Lundberg Farms with \$19.2 million in sales.

Highly commodified and traded on a global market, prices for conventional rice are currently at historic lows. Organic rice also felt downward pressure in 2000 and 2001 due to expanding supply. In a normal year, organic rice is roughly double the price of conventional rice. However with conventional prices trending down, the difference has been more like triple to quadruple the price of conventional.

Organic rice production is concentrated in the hands of relatively few growers. Leading the pack is Lundberg Family Farms, which claims to produce 65 percent of the organic rice grown in the U.S. It may be the largest organic rice producer in the world. Lundberg grows on 3,000 acres and partners with 28 other growers. It regards itself as a branded consumer goods company rather than a raw material supplier and has branched out into value-added products such as rice cakes, cereals and risotto. A model of vertical integration, Lundberg Farms now generates 50 percent of its business from packaged consumer goods. They are followed by Arrowhead Mills, a miller and bulk-branded supplier, with about \$6.1 million in retail sales in 2003.

## Grains Sales Trends, continued

### Organic Beans, Grains & Rice Brand Data

Beans, Grains & Rice	2003 Scanned Sales	2001 Scanned Sales
Lundberg	\$19,200,000	\$13,100,000
Arrowhead Mills	\$6,100,000	\$4,100,000
Lowell Farms	\$2,600,000	\$1,800,000
Texmati Rice	\$2,000,000	\$1,800,000
Ancient Harvest	\$1,400,000	\$1,100,000
Hayward	\$800,000	\$900,000
Woodstock Farms	\$400,000	\$100,000
<b>Sum</b>	<b>\$32,600,000</b>	<b>\$22,800,000</b>

*Source: Nutrition Business Journal Organic Foods Report 2004*

A number of broader dietary trends bode well for alternative grains, beans and related products. For instance, many analysts expect that USDA's new dietary guidelines will spur growing interest in fiber-rich foods like beans, amaranth, buckwheat and quinoa. Interest in gluten-free and allergen-free products also bodes well for alternative grains.

The biggest factor driving increased sales of gluten-free products is the rise in food allergies among children. According to Packaged Facts, more than 5 million children ages 9 and younger have food allergies, and companies are creating more products geared toward children.



## Dry Breakfast Foods

Total sales of dry breakfast foods in the United States topped \$9.7 billion in 1999. However, in more recent years the category has languished, with sales down slightly by 2001 at \$9.4 billion. By contrast, sale of organic cereals doubled between 1997 and 2003, when sales reached \$293 million. NJB projects a compound annual growth rate from 2004 through 2008 of 18.7 percent. SPINS listed Organic Cold Cereals among its fastest growing products for 2003, growth for that year estimated at 40.7 percent.<sup>29</sup>

Nature's Path is the leading organic breakfast cereal brand and claims to have 25 percent of the U.S. market for organic and natural cereals. Nature's Path sells primarily 100 percent organic cereals. However, most other leading manufacturers make both natural and organic cereals. General Mills made an initial foray into the organic marketplace with its Sunrise cereal under the General Mills label. Although the product remains on the shelf, sales proved disappointing, especially compared to gains made by functional cereals. However, General Mill's Cascadian Farm brand has catapulted to the number two position since its launch in 2002.

Golden Temple is the third largest producer of cold organic cereals, marketing cereals with organic ingredients as well as herbals such as ginkgo, ginger and Echinacea. Rapid growth in this category has been fueled primarily by expansion of Nature's Path, and the successful entry of the Kashi brand and Cascadian Farms. Kashi, a natural but not organic brand, acquired by Kellogg in June 2000, has enjoyed robust gains. Kashi's experience highlights how positioning in the mainstream cereal aisle can spark sales.

Among the fastest growing sub-categories are cereals fortified with ingredients rich in Omega-3 fatty acids like flax and hemp. For instance, sales of Nature's Path Optimum Power Breakfast Cereal with flax have increased an average of 47 percent annually since the cereal was introduced in 2000. The company's Flax Plus cereal is being tested in 350 Wal-Mart supercenters.<sup>30</sup>

While organic breakfast cereals get their start in the natural food retail channel, they are gaining ground in supermarkets' health food aisle and even in the mainstream cereal aisle. However, prohibitively high slotting fees and intense competition have kept independent nutrition industry companies out of the main cereal aisles in many supermarkets.

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<sup>29</sup> *Nutrition Business Journal Organic Foods Report, 2004.*

<sup>30</sup> *Natural Grocery Buyer, Winter 2005*

## **Baking Mixes, Supplies and Flours**

According to NBJ, retail sales of organic baking mixes, supplies and flours reached \$26.9 million in 2003 up sharply from \$19.5 million in 2001. Leading the pack among manufacturers was Arrowhead Mills with \$16.3 million, nearly two-thirds of the retail market. Oetker followed them with \$3.6 million, and Bob's Red Mill with \$2.4 million in 2003 sales.

### **Organic Baking Mixes, Supplies and Flours Brand Data**

<b>Baking Mixes, Supplies &amp; Flours</b>	<b>2003 Scanned Sales</b>	<b>2001 Scanned Sales</b>
Arrowhead Mills	\$16,300,000	\$13,900,000
Oetker	\$3,600,000	\$1,000,000
Bobs Red Mill	\$2,400,000	\$400,000
Maurys Cookie Dough	\$1,500,000	\$2,000,000
Sunspire	\$900,000	\$500,000
Organic Valley	\$800,000	\$600,000
Gold Medal	\$600,000	\$600,000
Lets Do	\$400,000	\$200,000
Hodgson Mill	\$300,000	\$200,000
Up Country Organics	\$200,000	\$100,000
<b>Sum</b>	<b>\$26,900,000</b>	<b>\$19,500,000</b>

*Source: Nutrition Business Journal Organic Foods Report 2004*

## **Gluten-free and Allergen-free Grains**

Although millions of people suffer from food allergies or intolerances, (an estimated 11 million people have food allergies and 30 million suffer from food intolerances, according to the U.S. Center for Disease Control and Prevention) the market for products has yet to adequately serve their needs. Often entire families follow similar dietary restrictions because making separate meals or preventing cross-contamination in food preparation is inconvenient and time-consuming. Because of this, there is a high demand for allergen-free products that taste like “regular” foods.

In January 2006 the Food Allergen Labeling and Consumer Protection Act went into effect that requires food manufacturers to clearly state if their products contain any of the “Big Eight” allergens. Those allergens identified are: nuts, peanuts, milk, eggs, fish, shellfish, soybeans and wheat. There is also a call for the FDA to issue a rule defining and permitting “gluten-free” labels by 2008.

Researchers at Packaged Food found that the market for allergen-free foods has doubled since 1999, from \$947 million in sales to more than \$1.8 billion in 2003. They expect the market to reach 3.9 billion by 2008. Unlike diet-based food crazes, food allergies and intolerances are primary health issues, and some people view allergen-free foods as solutions to a medical problem. The segment’s sales are escalating rapidly, and industry experts see no slowdown in sight.

Consumers are not only demanding allergen-free products, but also look for those with added ingredients like high fiber and omega-3s. Convenient allergen-free products have the potential to transform the market. Until recently, allergen-free products had to be made and consumed in the home in order to be considered safe to eat. Now it’s feasible to easily enjoy a gluten-free biscotti with a soy latte anywhere, opening up dietary possibilities for the allergic and food intolerant consumer.

It’s not just the allergic and intolerant who are drawn to allergen-free foods. Some consumers perceive these products, like dairy-free or wheat-free, as healthier alternatives and see eating them as part of a long-term dietary approach that reduces the risks of degenerative disease.

## **Linking Producers and Consumers Through Cooperative Business**

### **Strategic Co-op to Co-op Partnerships**

One means to forestall the competitive pressures outlined in this report is for independent organic and sustainable agriculture producers to **aggregate their marketing power through cooperation with like-minded producers.**

Whether through collective bargaining power in sale of commodities, or development of brand equity, cooperation among producers offers the opportunity to aggregate market power on the selling side of the transaction to attempt to offset concentrated market power on the buying side of the transaction.

Customers of any type of value-added product will require volume and consistency of supply, so producers will almost certainly need to be in alliance with other similar producers, such as through a producer-owned co-op or LLC.

**A key opportunity for organic and natural producers is to find strategic retail partners** who are also seeking to differentiate themselves from larger retail competitors.

Such retail partners are most likely to be independent stores, independently (family) owned mainstream chains, or food cooperatives. Producers need access to shelf space and customers, and a supportive retailer to “pull” their product through natural products distributors such as United Natural Foods Inc. (UNFI). Similarly, independent retailers need access to unique, high quality products that are different than the national brand found in Whole Foods or Krogers.

**The natural foods co-op sector is such a potential partner.** Not only do the co-ops need these types of products to differentiate themselves from retail competitors, but in the next 1-2 years will be negotiating a national distribution agreement with UNFI, and will be developing a national promotion and merchandising platform for their members. Such an alignment makes for a perfect opportunity to intentionally link producers and consumers through cooperative business.

Clearly there are opportunities for producer-owned businesses to develop and serve local markets for their products by finding a local retail partner. However, these opportunities are not limited to only local marketing. While food co-ops have a strong preference for featuring local, it is also true that not all products are produced in all parts of the country.

For example, the Pacific Northwest does not have a ready supply of naturally produced pork, and New England does not have a ready supply of organic orange juice from a producers’ co-op. **There is a distinct potential to link producer cooperatives in one region of the country to food cooperatives in another**, especially when they have products that do not compete with other local producers. Establishing linkages in this way allows the producer co-op to build supply chain relationships and brand identity in distant regions.

## **The U.S. Natural Foods Co-op Sector**

### **Size and Sales**

There are 250-300 natural foods consumer co-ops currently operating in the United States. Individual store sales range from a low of \$315,000 annually, to almost \$25 million annually. These organizations are democratically owned and controlled by their consumer members; typically each member owns a share of stock in the cooperative, and participates in the economic success of the business through patronage dividends.

The National Cooperative Grocers Assn. (NCGA), headquartered in Iowa City, Iowa, is a membership organization representing these food cooperatives. Collectively, NCGA member stores represent 103 stores in 32 states. Sales from these member co-ops were over \$700 million in 2005, making it one of the top five players in the natural foods retail channel. As a group they are one of the most vibrant and significant players in the industry.

In the U.S., natural foods co-ops were the birthplace for the organic and natural foods market we see today. Consumers interested in organic and natural foods organized themselves into buying clubs or co-ops in order to aggregate their individual purchasing power, and make it feasible to cost-effectively purchase organic and natural food from producers on both a regional and national basis.

Food co-ops are focused intensively on consumer education about healthy eating practices and environmentally friendly food production, resulting in a loyal and growing consumer base for these foods.

### **Competition**

The growth of the organic food movement in the U.S. was spurred by growing consumer concern about conventional production practices and an overall concern for health and wellness. In the 1990s, organic food sales began to grow at double digit rates (albeit from a small base), and began attracting the interests of innovative chain retailers such as Whole Foods and Wild Oats, as well as mainstream grocery retailers and manufacturers.

The broadened appeal of organic and natural foods in mainstream markets continues to grow, as evidenced by the fact that Wal-Mart is today the largest single retail buyer of organic and natural foods; projections show that mainstream retail markets will become the dominant source of organic and natural foods (55-60 percent of total sales) in this decade.

## Food Co-op Consumer Research and Branding

NCGA has strategically assessed the needs of food co-ops, and conducted consumer research through The Hartmann Group in order to identify competitive strategies to allow co-ops to continue to grow in the face of stiff mainstream competition. NCGA has identified key attributes that are competitive advantages for food co-ops in the marketplace battle.

- **Food co-ops continue to be the best and most trusted source of consumer education** in the industry, far surpassing mainstream grocers in their ability to respond to consumer questions about products, uses, and points of differentiation between organically and conventionally produced products.
- **Food co-ops are known and respected for their ability to source high quality locally or regionally produced products**, such as produce, dairy, and meats. This is particularly seen as a point of retail differentiation as grocery retail chains continue to consolidate and reduce the number of vendors they purchase from.
- Research shows that as more and more consumers explore healthy lifestyle choices, the **co-ops are well positioned to grow their sales** from “casual” or “occasional” buyers as they expand their consumer appeal from the “core” organic consumers who have historically been their base.

One strategy that has resulted from this research include the advancement of the “Co-op Advantage Program” (CAP), a national buying arrangement that food co-ops have though the NCGA with natural and organic manufacturers and distributors to enhance volume and strengthen buying power. This program allows food co-ops to give consumers competitive price breaks as well as enhancing their own buying efficiency. As the food co-ops leverage their buying power, they are also presenting a high-quality, high-profile brand image to consumers, including improved price image.

Products are promoted through standardized pricing and shared promotions. Standardized pricing comes from negotiations with manufacturers who offer their products at a reduced cost for the promotional (CAP) month and a commitment from the retailers to sell these products at a predetermined price (in many cases lowering the store’s applied margin for these products). These products are promoted through a shared CAP flyer that is available in a number of ways: some stores send the flyer out with their newsletter, others send out just the flyer and many stores have the flyers available in store for shoppers. Along with the Cap flyer POP signs are also made available to the retailers for the promoted products. In addition to the written materials most stores merchandise many of the CAP products on their end caps for high visibility to maximize sales and present a strong price image.

## **Food Co-op Consumer Research and Branding, continued**

A system to accommodate promotion of producer co-ops products to smaller regions (not nationally) appears to be in place for the CAP program. The CAP Coordinator can choose a “local/regional” product that is not available throughout the country and promote these products through the CAP flyer. The retailers that were interviewed for this project stated their desire to promote as many local products as is feasible as this approach fits with their internal philosophy as well as their marketing/branding approach.

Buyers and merchandisers encouraged producers to make use of other tools in addition to the use of the CAP program, in order to secure successful placement and sales in the retail cooperatives.

- a. Samplings are an important part of new product entry. For meat products this could be essential as the price point on organic and naturally raised meat can create sticker shock for the consumer.
- b. Samplings with a local grower in attendance would be advantageous in order to offer information directly to the consumer.
- c. Advertising dollar allowances help drive the retailer to promote these products.
- d. Introductory sale/price-deep discounts create attractive price points.
- e. Collateral material (written materials which could be posted by the product or hand outs for consumers) are useful.
- f. A statement of the growers environmental practices (assuming they practice sustainable agriculture or other environmentally friendly approaches) are important to many natural foods shoppers.
- g. Organic certification if the product is organic.
- h. Packaging should be attractive and easy to read with nutrition and ingredient information on it. (Also a UPC if possible). Meat is best sold in Kry-o-vac packaging as this allows the consumer to view the product and increases shelf life.
- i. A newsletter interview with a new vendor quickly introduces the producer to the community.

## Distribution

Historically, the natural foods co-ops purchased their wholesale goods from wholesalers that they cooperatively owned; examples include Northeast Cooperatives in New England, and North Farm and Blooming Prairie in the Midwest. Beginning in the 1990s, corporate distributor United Natural Foods, Inc. (UNFI) began an aggressive expansion effort, buying produce distribution companies such as Albert's Organics, as well as cooperatively owned warehouses.

In 2003, UNFI consummated the purchase of the last two major co-op warehouses, Blooming Prairie and Northeast Cooperatives, and thus became the undisputed dominant distributor of the natural and organic foods in the country. UNFI today serves natural foods supermarkets such as Whole Foods, regional co-op grocer associations, and both independent and chain mainstream grocers. UNFI is the primary supplier to food co-ops nationwide, with four regional buying agreements in place with regional co-op grocer associations.

Just as regional cooperative grocer associations once negotiated buying terms with their regionally owned co-op warehouses, NCGA is now in the process of preparing to negotiate their first national purchasing agreement with UNFI. Such an agreement would aggregate the purchasing power of all co-ops nationwide in order to allow individual co-ops to remain competitive in their cost of goods vis a vis Whole Foods and mainstream retailers. NCGA anticipates replacing the four regional buying agreements with one national agreement in 2006.

Below is a list of specific criteria (both required and recommended) that producers must/should be presented by producers to UNFI for them to consider carrying a product:

### Required Information:

-Product list of items you wish for the buyer to consider.

- Product ingredients list for said product(s).
- Price list specifying our cost of goods. Please indicate if the pricing is based on FOB or delivered costs, and where your products are shipped from or warehoused.
- Buyers purchasing requirements and/or minimums.
- Samples.

### Recommended Information:

- A brief summary of your company/ products expressing the qualities that set your items apart from others in the industry.
- Documented interest from existing or future UNFI customers.
- Copies of recent recognition received by your product(s).
- Any further information you feel UNFI should know about your product(s).
- Certificate of Liability Insurance



### **Affinity for producer cooperatives**

The modern cooperative community recognizes seven major principles that serve as the standards for cooperative business. The Sixth Principle is “Cooperation among cooperatives.” The concept behind this principle is that cooperation benefits all cooperatives, and that it is in the strategic long term interests of all cooperatives to foster and support other cooperatively owned ventures.

Of particular relevance here, there is a strong philosophical imperative for consumer-owned food co-ops to use their purchasing power to support farmer-owned co-ops that produce or process natural or organic foods. This is particularly amplified in light of the desire for food co-ops to differentiate themselves to their consumers through the products they carry. Products once found only at food co-ops are standard offerings at Wal-Mart. Rather, food co-ops today are in the process of seeking out authentic, high quality products that they can purchase from producer co-ops, using this Sixth Principle as a means of differentiating themselves from their non-cooperatively owned competitors.

## **Existing Producer-Retail Cooperative Partnerships**

### **Co-op Atlantic “Market Town” and “Atlantic Tender Beef Classic” Labels**

There is precedent in North America for producer-retail cooperative partnerships. For more than 75 years, Co-op Atlantic has linked farmer cooperatives and consumer cooperatives within a single structure in Maritime Canada. Co-op Atlantic serves 226,000 member families by providing products and services to its 134 member cooperatives in the food retail, housing, petroleum, feed mill, and farm supply sectors. Sales exceed \$500 million annually.

Co-op Atlantic’s Agricultural Division buys and merchandises grain, sells animal feed, and other farm supplies to agricultural producers in the region. Co-op Atlantic also operates 74 full service conventional retail stores, 30 discount groceries, and 27 farm supply stores. The consumer foods division accounts for \$350 million of the co-op’s gross sales. The conventional store format is typically first or second in market share in the markets they serve.

Co-op Atlantic has developed private label products from producer cooperatives for its retail locations. The “Market Town” label features products manufactured or grown in the Atlantic provinces. In 1999, Co-op Atlantic introduced the “Atlantic Tender Beef Classic” label. The co-op introduced the line after consumer research indicated that their consumer members desired strong preferences for purchasing locally raised beef (96 percent), and knowing how and where the product was produced (86 percent).

A joint effort was developed between the Consumer Foods Division and the Agricultural Division of the cooperative. Producers wishing to sell into the program were required to be co-op members and had to abide by the feed and husbandry standards. The Atlantic Tender Beef Classic is only sold in Co-op Atlantic’s retail stores and is not available elsewhere, creating a signature product for the retailer. Atlantic Tender Beef Classic received national recognition in 2002 as the winner of the Canadian Grand Prix award for private label perishables.

When the beef packing plant that was originally used by the program was bought and closed in 2002, Co-op Atlantic worked to develop a producer cooperative that would invest in a new plant in Prince Edward Island. The co-op contracted to buy all of the qualifying beef for the line, thus providing plant investors and lenders with a key market for the plant’s output.

To date, the program has been very successful, generating more than \$17 million in annual sales. The success of this effort has encouraged Co-op Atlantic to create additional partnerships and private label products in conjunction with other producers of poultry, potatoes, fish and other commodities. These other ventures have also generated substantial sales: Atlantic Tender Chicken, for example, grosses \$4 million in annual sales.

## **Organic Coffee Producers and “Small Farmer” Label**

There is also precedent for this concept of “cooperation among cooperatives” in international commerce.

Many U.S. food co-ops already have developed purchasing relationships with coffee producer cooperatives in Central America, often through assistance from the U.S. Agency for International Development. Coffee beans for these products are grown organically on small family-owned plots, processed by a producer-owned cooperative, and sold in retail co-ops in the U.S.

As a result of a 2003 tour sponsored by the National Cooperative Business Association (NCBA), Lakewinds Natural Foods in Minnetonka, Minn., established direct relationships with Nicaraguan coffee producer co-ops to purchase fair trade certified organic shade-grown arabica. The result has been over a ton of coffee that has been exported to the U.S. under the “Small Farmer” label, with price premiums of \$3.25-\$4.25 per pound, and the creation of new market relationships.

Because food co-ops invest so heavily in member and consumer education, co-op shoppers are aware of how their purchasing decisions have impact on family farms, and how this in turn spurs economic development in rural communities in Central America. The same principles can be easily transferred to the domestic marketing of cooperatively produced goods.

## **Food Co-op Buyer Survey: Opportunities for Producers**

CDS staff conducted interviews with knowledgeable food co-op buyers and group purchasing coordinators on a national and regional basis to gather information about sales trends, attributes of desired products, and product categories that are experiencing growing consumer demand or are underserved. The interviews focused on the following departments: produce, dairy, meat, non-dairy beverages and grains.

In addition to identifying product trends and opportunities in the natural and organic market, food co-op buyers also noted that their buying decisions are often values-driven, based on the co-op principles or their cooperative's mission. Helping to develop and sustain local economies is codified in the way they do business. Buyers stated they are willing to work with small, local or artisan producers in an effort to advocate for them and bring their unique products to the consumer. They are also willing to buy transitional and conventional products and educate consumers about them to support local growers.

Value-added production attributes were also especially important in their buying decisions, including: Local and organic, rBGH-free, grass-fed, fair trade, sourced from family farms, and humane animal husbandry practices. The buyers also expressed enthusiastic interest in buying more products sold by producer co-ops.

In addition to identifying growth opportunities in various departments, buyers also give priority and more consideration to products with the following attributes:

- Locally and organically grown
- Close producer-retailer relationship
- In sync with co-op's mission for supporting sustainable, ecologically sound business models
- Fair trade business practices

## **Product Categories**

The areas of product growth identified by retail food co-op buyers are aligned with the research conducted on the natural and organic marketplace in this report. In addition to production attributes discussed on the previous page, buying decisions are driven by consumer preference for high quality, value pricing, freshness and convenience. Buyers are actively seeking the following products to meet market demand:

### Produce

- Locally grown frozen fruits and vegetables
- Organic local fruits
- Salad greens
- Precut fruits and vegetables

### Dairy

- Goat milk and butter
- Soy yogurt
- Organic cheeses
- Organic yogurt
- Organic eggs
- Grass-fed butter
- Non-homogenized milk in bottles
- Kefir

### Meat

- Beef
- Poultry
- Seafood
- Sausage and deli meats

### Non-dairy Beverages

- Perishable, fresh juices
- Soymilk
- Prepared smoothies and shakes
- Fortified water
- Single-serve beverages

### Grains

- High-fiber foods
- Flax- and hemp-enriched breads
- Gluten-free baked goods
- Prepared dry mixes (soups and dinner mixes)
- Ancient grains (quinoa, spelt)

## Summary of Market Opportunities

Consumer demand for natural and organic products continues to grow as these goods enter the mainstream through conventional distribution channels. The marketplace continues to offer worthwhile opportunities for producers and retailers, and potential tangible benefits for expanded producer-retail cooperative business relationships.

- Many natural and organic categories are predicted to achieve significant growth through the next decade.
- New categories of organic foods are constantly being introduced and the organic category is rapidly overtaking naturals in consumer choice.
- Main issues for consumers are taste, convenience and nutrition—food that’s good for you that you can get fast.
- Successful manufacturers will be those that can identify trends and get new products into the hands of consumers.
- Those manufacturers who demonstrate a strategic understanding of the consumer and are persistent in public education or public relations will increase brand recognition.
- Predicted top sellers include:
  - Organic frozen and refrigerated meats, poultry and seafood
  - Bread and baked goods, especially allergen-free
  - Packaged fresh produce
  - Dairy
- Substantial new organic dairy is required to fulfill needs for current organic dairy processors.
- Products that can move from the natural and organic market niche into the mainstream will enjoy strongest growth.
- Producers/manufacturers must be savvy in creating effective market entry strategies that will leverage consumer/retailer interest, and secure efficient product distribution.